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Farms Become Large Complex Businesses

Should You Incorporate Your Farm?

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Corporation is another form of farm business organization to be considered, along with partnership and sole proprietorship. The *advantages* and *disadvantages* of incorporating the farm business *depends to a great extent upon the size and nature* of the enterprise and the *objectives of the owner*. An advantage to one farmer may be a disadvantage to another.

Much thinking and planning must be done by those interested in forming a farm corporation before they change the form of farm business. The need for competent legal advice is paramount.

1. Why is this question of incorporating being asked in modern farming?

Present day technology in farming has necessitated, in many cases, larger units; thus more capital is involved in both the land and the cost of operation. Capital investment for many Ohio farm families ranges from $50,000 to over $150,000. This has increased the problems of transfers of ownership from one generation to another, increased the need for multiple ownership, and has magnified the problem of obtaining credit.

2. When was the law concerning incorporating the farm business changed, and what was the change?

A change in the federal tax law was made in 1958, eliminating the double taxation of the income of small corporations and thereby authorizing the so-called "pseudo corporation." Under this change, a small corporation which meets certain requirements may elect not to pay income tax as a separate taxpayer. The shareholders report their shares of the total corporate income on their own individual tax return. This advantage of allocation of income to shareholder-owners may be very significant.

These pseudo corporations operate as true corporations except in regard to federal income tax regulations. Among the requirements are that the corporation have less than 11 stockholders, that it not be affiliated with a larger corporation, and that it have only one class of stock outstanding. In addition, all stockholders must be individuals, an estate or estates; no stockholder can be a non-resident alien, and all stockholders must agree to the pseudo agreement.

3. What are some advantages of incorporating your farm?

A. *A good method of distribution and transfer of ownership of the farm.*

Individual proprietorship ceases at the owner's death; a corporation does not, if a stockholder dies. It is an orderly way of transferring property either by gift or by a plan of buying it gradually.

Another advantage along this line is the possibility of savings or reduced inheritance taxes, through gifts of shares to children while parents are still living.

B. *There is limited individual liability.*

This advantage is high on the list by most writers on the subject of incorporating the farm business. However, if the financial institution makes the stockholders as individuals sign notes, it loses most of this advantage.

The shareholder is liable for debts of a corporation only to the extent of the shares of stock he owns unless he has signed a surety for a corporate debt. It must be kept in mind, however, that if a corporation becomes insolvent, shares in it are worthless. If this happens and all the farmer's assets are in shares of the corporation, he loses all of his property. Just as the shareholder is not personally liable for corporate debts, a corporation is not liable for a shareholder's personal obligations.

C. *Acquisition of more capital in farming.*

The previous two listed advantages could have favorable implications as far as holding and attracting more capital into farming. It is conceivable that following a projected plan for transfer of property to save taxes would result in more capital for use on the farm. Also a liability law suit could be less detrimental to individuals in a corporation thus leaving them in better position to start again later with capital not tied up in the corporation. However, acquisition of more capital in farming is not a main reason for incorporating. Nor does it necessarily improve the chance to get more credit.

Under existing conditions incorporation does not appear to be a popular or effective method of raising funds from outside the family for the purchase or expansion of the farm business. Incorporation may provide a good device for pooling family capital. Of course, the corporate form cannot solve personal problems or family quarrels; if the individuals involved cannot get along, incorporation will not help them.

D. *Possible increased efficiency.*

The records and business methods under the corporate form are often superior to those used before incorporation. Thus, the business might improve its efficiency from this standpoint. Some records are a necessity and are required by the law. Another attraction for investors or creditors is the continuity of corporate operation, which also contributes to overall efficiency. The business does not collapse when the shareholder, officer or director dies or retires.

E. *Liability Insurance.*

Liability insurance (workmen's compensation insurance) was formerly available only for hired help. Under the corporate form, however, shareholders that are employees are eligible. This is also true of social security and hospitalization.

4. What are some disadvantages of farm incorpation?

A. The formal organization and records required may be considered a disadvantage by some.

B. Reports must be filed with the state when the corporation does certain things such as increasing its capitalization or issuing additional shares. An annual report of business must also be filed.

C. Fees and taxes involved in getting the corporation established and the state franchise tax due each year would be in addition to the normal tax under individual ownership.

The filing fee is based on the number of shares authorized by the Articles of Incorporation. The minimum fee is $50. On the first 1 to 1,000 shares there is a 10 cent per share filing fee, on the next 1,001 to 10,000 shares the fee is 5 cent per share, etc. Lawyer fees and secretarial costs would need to be included, these may amount to $100 or more.

The annual Ohio franchise tax is ~~four~~ mills tax on the valuation of the assets on hand at the end of each year.
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5. Farming should be considered as a business.

The best business techniques must be used by the modern farmer to make his returns profitable. This makes it easier for him to meet his goals and enjoy a wholesome way of life.

Incorporating may be a technique you will want to consider. A corporation, for instance, doesn't have to be a huge thing with a "big business" connotation. It can be very much a family affair assuring family continuity of farm ownership, permitting earnings to be distributed in the most appropriate way for the status of the owners and operators. They may receive surplus over direct costs either as salaries or shared with stockholders as though they were partners.

The family farm corporation is a possibility as a form of farm organization in solving ownership, capital, management and tax problems.

Sources of Additional Information:

1. North Central Regional Extension Publication No. 11, "The Farm Corporation," June 1960.
2. Ohio—MM 171 Bulletin, "Incorporating the Farm Business," 1959.

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STATE INCOME TAX AT 4 PERCENT ON FIRST $25,000 NET INCOME AND 8 PERCENT ON ALL INCOME OVER $25,000 WHICHEVER IS THE HIGHER TAX.

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